MEMORANDUM

To: **USAID/Afghanistan CTOs**

From: **Jeff Lifur, Regional Legal Advisor**

Date: **September 5, 2005**

Subject: **Tax Exemptions for USAID-Source Income – Frequently Asked Questions**

A new income tax law will be going into effect in Afghanistan with an estimated implementation start date of September 22, 2005. The onset of the new law has triggered many questions from USAID implementing partners as to what tax exemptions exist vis-à-vis U.S. Government bilateral agreements with the Government of Afghanistan (GOA). Information related to the questions of most general interest follow. CTOs are encouraged to share this information with their implementing partners.

CTOs should make clear to implementing partners that the information provided here should not substitute for each implementing partner seeking its own tax advice and consulting with the GOA's Tax Authority located in the Ministry of Finance. USAID expects each of its implementing partners to fully comply with Afghan law.

Question 1: What U.S.-Afghan Bilateral Agreements Include Tax Exemption Provisions Covering USAID Assistance?

The Point Four General Agreement for Technical Cooperation, dated February 7, 1951, is the framework bilateral agreement for all USAID activities in Afghanistan. It includes a provision that states that:

> *Any funds, materials and equipment introduced into Afghanistan by the Government of the United States of America pursuant to such program and project agreements shall be exempt from taxes, service charges, investment or deposit requirements, and currency controls.*

USAID is currently negotiating four over-arching Strategic Objective Grant Agreements (SOAGs) with the GOA that will encompass all of the programs that USAID finances in Afghanistan. The SOAGs will contain a tax exemption provision that follows from and clarifies the scope of the tax exemption contained in the 1951 Bilateral Agreement. The tax exemption provision is the standard provision that exists in similar USAID SOAGs in other countries throughout the world. The SOAGs are still being negotiated. The information that follows is based on the interpretation of the 1951 Bilateral as clarified by the SOAG tax exemption provision.

Question 2: Do the Tax Exemption Provisions Discussed in Question 1 Above Provide a Blanket Tax Exemption for All USAID Implementing Partners for All Taxes in Afghanistan?

No. For USAID implementing partners, the tax exemptions described here only apply to USAID-source income. For income received from any other source, including other U.S. Government agencies, implementing partners should check with those sources to determine whether any such non-USAID source income also benefits from a tax exemption.

Question 3: How do the Tax Exemptions Discussed in Question 1 Above Affect Payment of the "Rental Property Tax" in Afghanistan?

The rental property tax imposes a 20% tax on landlords for real property that rents for more than approximately $1,000 monthly. The law requires the renter to withhold the tax on behalf of the landlord.

The rental property tax is a tax on the landlord not on the renter. The withholding is merely transferring a part of the landlord's income (the rent) to the GOA to cover the tax. It is up to the lease or rental agreement between the landlord and the renter to address how the private parties address the withholding. There is no requirement that the landlord pass the tax along to the renter, and the landlord and renter can agree that the renter may offset the amount of the withholding from the monthly rent. The parties can also agree that the renter will pay the landlord's tax on behalf of the landlord.

Whatever the arrangement between landlord and renter, the USAID tax exemption is not applicable to the renter since the renter is not responsible for the tax.

Question 4: How do the Tax Exemptions Discussed in Question 1 Above Affect Payment of Customs Duties, Tariffs, Import Taxes or Other Levies on the Importation, Use and Re-Exportation of Goods into or out of Afghanistan?

The tax exemptions apply to all goods brought into the country for use on a USAID-financed assistance project. The exemption applies to such goods whether they are brought in by Afghan national or non-Afghan implementing partners.

In addition, non-Afghan implementing partners may bring in personal belongings and effects (including personally-owned automobiles, for example) for their personal use (not for resale, however) and for the personal use of their family members.

Question 5: How do the Tax Exemptions Discussed in Question 1 Above Affect Payment of the Income Tax in Afghanistan?

In Afghanistan there is an income tax on organizations and individuals. There is also a business receipts tax which is a type of income tax on gross receipts of for-profit organizations.

The tax exemption described above exempts all non-Afghan national implementing partners from paying taxes on their income, profits, or property. This includes social security or other similar type of taxes. The exemption does not extend to Afghan nationals. It does extend to USAID-financed non-Afghan organizations and non-Afghan employees of USAID-financed implementing partners (whether such implementing partner is Afghan or non-Afghan). Once again, however, it should be noted that the exemption only applies to USAID-source income. Income received by organizations or individuals that cannot be tracked back to USAID is not subject to the exemption. If organizations or individuals are receiving income for assistance activities from other donors or other U.S. government agencies, they should check with such donors to see if any tax exemptions are applicable to such income.

It is USAID's understanding that the GOA income tax form includes a procedure for documenting exemptions offered under bilateral agreements. Non-Afghan national implementing partners and non-Afghan individuals receiving USAID-source income can check with the Ministry of Finance's tax office to obtain more details on the required documentation.

Question 6: How do the Tax Exemptions Discussed in Question 1 Above Affect Payment of the VAT, Sales Taxes, Taxes on Purchases or Rentals of Real or Personal Property or other Taxes Levied on the Last Transaction for the Purchase of Goods or Services Financed by USAID in Afghanistan?

It is USAID's understanding that VAT and sales taxes are not currently in place in Afghanistan. To the extent that such taxes are imposed in the future, the tax exemption will apply for goods and services purchased for use in activities financed by USAID. To the extent the purchase of a good or service would not be an allowable cost under an implementing partner's agreement with USAID, the exemption would not apply (for example, individual employees' purchases of personal effects are not allowable costs under USAID assistance agreements and therefore would be subject to the sales tax should one be instituted in Afghanistan).

Question 7: What Happens if the GOA Collects a Tax Despite the Existence of an Applicable Tax Exemption?

USAID will work with the GOA through the MOF to try to ensure that, when exemptions apply, no taxes will be collected. However, it is likely that there will be cases where taxes will be collected despite the best intentions of all parties to comply with the terms of the bilateral agreements. USAID agreements with implementing partners should contain a provision related to reporting of foreign taxes. If an implementing partner's agreement does not contain such a provision, it should contact its USAID Contracting Officer or Agreement Officer and request inclusion of such standard provision. USAID will then seek reimbursement of such taxes from the GOA. Implementing partners should also advise USAID if there appears to be a tax being charged that should be subject to an exemption so that USAID can discuss the situation with the GOA.

If an implementing partner has any question about whether its payment of a tax under its agreement with USAID would be an allowable cost under its grant or contract, it should check with its USAID Contract or Agreement Officer for clarification.

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It is expected that implementing partners may have additional questions about specific details that may not have been addressed in this memorandum. Some questions will need to be addressed by the implementing partners' own tax advisors or the GOA Tax Authority. However, questions related to the USAID tax exemptions and problems encountered with collection of taxes where exemptions apply should be brought to USAID's attention for further consultations.